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TAXATION OF BUSINESS CORPORATIONS

Address by J. F. Zoller, of Schenectady, N. Y., before the Thirteenth Annual Convention, Real Estate Association, State of New York, at Long Beach, L. I., October 19-21, 1916.

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Taxation of Business Corporations

The theme of this paper is the need of changes in the present tax law for the purpose of properly taxing the personal property of business corporations in the State of New York, so that such capital may continue to come here and remain here, and at the same time bear its just proportion of the taxation burden of the State. In order to fully realize the need of fundamental changes in the tax law relating to taxation of personal property of business corporations it seems necessary to consider briefly some of the provisions of the present tax law, some of the tax bills offered at the last session of the legislature and some of the methods adopted in an attempt to properly administer the present law.

TAXATION OF PERSONAL PROPERTY

We will first refer briefly to the provisions of the tax law concerning the taxation of personal property.

TAXATION OF PERSONAL PROPERTY OF DOMESTIC CORPORATIONS

Section 12 of the tax law provides as follows:

> "The capital stock of every company liable to taxation, except such part of it as shall have been excepted in the assessment roll or shall be exempt by law, together with its surplus profits or reserve funds exceeding ten per centum of its capital, after deducting the assessed value of its real estate, and all shares of stock in other corporations actually owned by such company which are taxable upon their capital stock under the laws of this State, shall be assessed at its actual value."

While the section refers to "capital stock" the courts have held that "it denotes the property owned by the corporation, and not the par or actual value of the shares of the stockholders." (People ex rel. Second Ave. R.R. v. Barker, 72 Hun, 126; Oswego Starch Factory v. Dolloway, 21 N. Y. 449; People ex rel. Panama R.R. v. Com'rs. 64 How. Pr. 405.)

It therefore follows that the provision provides for the taxation of the personal property of domestic corporations and includes as personal property, the difference, if any, between the actual value and the assessed value of the real estate. If, however, the corporation has a surplus it may deduct such a proportion of such surplus as does not exceed 10% of the issued capital.

There are many objections to this section, among which are the following:

(a) The difficulty in making an assessment under the section due to the complexity of the method adopted.

Innumerable decisions have been rendered under this section and the average assessor can hardly be expected to be familiar with such decisions or to fully apply such decisions in making an assessment of personal property under such section.

(b) The ease by which the section may be evaded by corporations desiring for any reason to escape taxation upon personal property.

Corporations can avoid assessment of their personal property under such section by issuing sufficient bonds to offset all the other property considered under the section in ascertaining the taxable value. They may also materially reduce the amount of tax payable under the section by locating their principal offices in rural localities where the tax rate is low, thereby escaping all personal property taxation in the district where the business is actually transacted and where the personal property is actually located and protected and where the tax ought to be paid.

(c) The discrimination against those corporations that desire to transact business without debts, and to pay their just proportion of the tax burden in the tax district where their business is transacted.

It should be noted that this section contemplates a full assessment upon all personal property both tangible and intangible, plus the difference, if any, between the actual and assessed value of the real estate, such property to be taxed under the section at the general property rate. As there is no analogous rule provided in the tax law for the assessment of such property owned by foreign corporations, individuals or copartnerships, as we shall hereafter see, the section necessarily discriminates against domestic corporations, unless they see fit to resort to the tax-dodging method of locating their principal office in some out-of-the-way neck of the woods, or go in debt. Therefore,

the very corporations which are of the most benefit to the State and which should be encouraged to locate in the State are discriminated against under the section.

TAXATION OF PERSONAL PROPERTY OF FOREIGN CORPORATIONS

Section 7 of the tax law provides as follows:

> "Non-residents of the State doing business in the State, either as principals or partners, shall be taxed on the capital invested in such business, as personal property, at the place where such business is carried on, to the same extent as if they were residents of the State."

It should be noted that there is no specific provision for the taxation of the personal property of foreign corporations, but the foregoing provision applying to non-resident individuals generally has been construed so as to apply to the property of foreign corporations invested in business in the State. (International Banking Co. v. Raymond 117 App. Div. 62; People ex rel. Rurand Ruel Co. v. Wells, 180 N. Y. 506; People ex rel, Farcy & Oppenheim Co. v. Wells, 183 N. Y. 264.)

TAXATION OF PERSONAL PROPERTY OF INDIVIDUALS

Section 6 of the tax law provides as follows:

> "All real and personal property subject to taxation shall be assessed at the full value thereof, provided, however, that the owner of personal property shall be allowed a deduction from the full value of all his taxable personal property to the extent of the just debts owing by him, but no such deduction shall be allowed by reason of the indebtedness of the owner contracted or incurred in the purchase of non-taxable property or securities owned by him or held for his benefit, nor for or on account of any indirect liability as suretv, guarantor, indorser or otherwise, nor for or on account of any debt or liability contracted or incurred for the purpose of evading taxation."

Section 8 of the tax law provides:

> "Every person shall be taxed in the tax district where he resides * * * for all personal property owned by him or under his control as agent, trustee, guardian, executor and administrator * * * ."

TAXATION OF PERSONAL PROPERTY OF COPARTNERSHIPS

There is no provision in the tax law for the taxation of copartnerships as such. The personal property of copartnerships can be taxed only to the different individuals composing the copartnership.

REPORTS TO LOCAL ASSESSORS IN CONNECTION WITH ASSESSMENT OF PERSONAL PROPERTY

Individuals, copartnerships and foreign corporations are not required to make any report whatever to local assessors in connection with assessments of personal property under the tax law. Domestic corporations, on the other hand, are required to make the report to local assessors prescribed by Section 27 of the tax law. Such section reads as follows:

> "The president or other proper officer of every moneyed or stock corporation deriving an income or profit from its capital or otherwise shall, on or before June first, deliver to one of the assessors of the tax district in which the company is liable to be taxed, a written statement in the form prescribed by the tax commission specifying:
>
> "(1) The real property, if any, owned by such company, the tax district in which the same is situated and, unless a railroad corporation, the sums actually paid therefor.
>
> "(2) The capital stock actually paid in and secured to be paid in, excepting therefrom the sums paid for real property and the amount of such capital stock held by the State and by any incorporated literary or charitable institution, and
>
> "(3) The tax district in which the principal office of the company is situated, or in case it has no principal office, the tax district in which its operations are carried on."

If such statement is not made within twenty days after the first day of June or is insufficient, evasive or defective, the assessors may compel the corporation to make a proper statement by mandamus.

Section 28 of the tax law provides a penalty of $250 for wilful neglect to furnish such report.

This is the only form of report required by law in connection with the assessment of personal property by the local assessors.

It should be noted that this report requires three things only to be stated, viz.:

(a) The amount and location of the real property and the sums paid therefor.

(b) The amount of paid-up capital stock.

(c) The location of the principal office.

At the last session of the legislature an amendment was offered to the tax law, giving the State Tax Commission power to prescribe the form of report which should be made by corporations for the purpose of an assessment under Section 12 of the tax law. The result of this report undoubtedly would have been a full assessment of corporations under Section 12 of the Tax Law and a full discrimination against those corporations before referred to who had not created debts and had located their principal office in the district where their operations were carried on. This bill did not become a law.

After the close of the legislative session last year there was prepared and forwarded to the assessors throughout the State by the State Tax Commission a certain letter of instructions dated April 28, 1916. Such letter was as follows:

April 28, 1916.

"To the Board of Assessors:

"You are about to begin your field work in the assessment of property in your tax district. In line with the duty imposed upon the State Tax Commission by the Tax Law of the State we urge you to obey the law, particularly in the requirement that all property shall be assessed at full value.

"*Do* your *full* duty under the law!

"*Don't* copy the old roll or follow the old methods!

"*Do* make a *real* assessment roll to which you can append your conscientious oath!

"*Don't* permit your district to be *the one* in which the law is not observed!

"Organize a County Assessor's Association and agree on above plan in your County!

"In most cases under-valuations result in discrimination in favor of the large property owners and against the smaller ones. *All should be treated exactly alike.* You should not be concerned with other tax districts, for the State Tax Commission is making every effort to bring about much needed reforms in all of the tax districts of the State. There will be no direct State tax this year, so that the question of putting property on the full value basis is almost entirely a local one. If you make low assessments you will have a high rate of taxation, and one result of this will be the failure to assess any personal property, and real estate will bear the entire burden.

"Your particular attention is also called to the assessment of stock of corporations liable under Section 12 of the Tax Law. Every such corporation which has its principal place of business in your tax district should be assessed upon its capital stock by

you. To make an effectual assessment, assess every such corporation at an amount equal to its capital share stock, except corporations which you have been assessing at a valuation higher than the par value of their capital stock. When a corporation objects to your assessment have it file a sworn statement upon the blank which this department will furnish you for such purpose. Cities may use their own blanks, if they have them, until further orders from the Commission. If a corporation doing business in your tax district claims that its principal place of business is in another tax district, kindly notify the assessors of that district so that they may assess that corporation there; also notify the State Tax Department to the same effect.

"Please call this communication to the attention of your colleagues. Very truly yours,

"MARTIN SAXE, President;
"WALTER H. KNAPP,
"RALPH W. THOMAS,
"State Tax Commission."

The forepart of the letter referred to the assessment of property in general regardless of the character of the owner, and the assessor was urged to assess all property at full value. No rule, however, was suggested to enable the assessor to make a full assessment of all personal property.

Following these general instructions applicable to all property "particular attention" was called to the assessment of corporations under Section 12 of the tax law, and a rule was suggested to enable the assessor to make a full assessment of the personal property of domestic corporations. The rule prescribed for the assessment of the personal property of corporations under Section 12 was to assess every such corporation at an amount equal to its capital share stock, except corporations which had been assessed at a valuation higher than such par value.

The letter of instructions further stated:

> "When a corporation objects to your assessment have it file a sworn statement upon the blank which this department will furnish you for such purpose."

The form of blank referred to follows:

"OFFICE OF THE BOARD OF ASSESSORS.
City or Town of _____ County or _____
Application for Revision of Assessment for year 191_____

Assessed pursuant to Section 12 of the Tax Law.
The _____
(Please state full name of the corporation.)
a corporation organized under the laws of the State of New York, claiming to be aggrieved by the assessed valuation of its personal property for the year, makes application by the undersigned, one of the officers of the said corporation, to have the same revised and corrected.

STATE THE VALUE OF THE FOLLOWING ITEMS:

ASSETS

All assets must be scheduled, whether located in the State of New York, or elsewhere, including deposits in banks and debts due from non-residents.

1. Real Estate _____$_____
2. Machinery, plant, office furniture and fixtures other than real estate _____$_____
3. Goods, wares and merchandise_____$_____
4. All other tangible personal property (this does not include mortgages or credits)_____$_____
5. Cash on hand and on deposit_____$_____
6. Debts due from solvent debtors (this includes bonds and all credits, also "secured debts")_____$_____
7. Shares of stock of other corporations_____$_____
8. Value at which patent rights, copyrights, trademarks, good will and franchises were taken in payment for capital stock_____$_____
9. The aggregate of the above assets_____$_____

DEDUCTIONS

Except the items numbered 12, 15, 17 and 18, the value of every item to be deducted must be the sum at which it is included in the above statement of assets.

10. Property exempt by law, which includes
    - U. S. Bonds, N. Y. State and Municipal Bonds _____$_____
    - N. Y. Mortgages recorded on or after July 1, 1906, and mortgages on which a registration tax has been paid since May 13, 1907, also "secured debts." (This includes only mortgages and "secured debts" owned by the corporation) _____$_____
    - Goods imported by above corporation from foreign countries on hand in unbroken original packages_____$_____

11. Value at which patent rights, copyrights, trademarks, good will and franchises were taken in payment for capital stock ----------$------

12. So much of the surplus, if any, as shall not exceed ten per centum of the par value of the shares of stock issued ----------$------

13. Shares of stock of other corporations actually owned by the above corporation which are taxable upon their capital stock----------$------

14. Tangible personal property having a permanent situs outside of this State, specifying its nature and location. (This does not include bonds, notes, evidences of debt of any kind, currency, deposits in banks, bills receivable, or any other intangible property) ----------
---
---

15. The assessed value of the corporation's real estate in this State, including its special franchises-----$------

16. Real estate outside of this State, specifying its location ----------
----------$------

17. Indebtedness secured by the corporation's bond and mortgage on real property to which corporation now holds title ----------$------

18. All other indebtedness of the corporation not contracted or incurred in the purchase of non-taxable property or securities, or for the purpose of evading taxation. (The amount owing for goods imported by above corporation from foreign countries on hand in unbroken original packages and the capital stock of the corporation must not be included.)
Itemized as follows:
Bonds not secured by mortgage of real estate ----------$------
Notes --------$------
Open Accounts-$------

19. The aggregate of the items set down in answer to questions 10 to 18, inclusive----------$------

ADDITIONAL INFORMATION REQUIRED

a. Total par value of capital stock issued-----$------
b. Rate of last dividend----------Date---

c. Amount of surplus, if any as shown by the books ----------$------
d. Amount of indebtedness for above imported goods; this amount is not included in No. 18, but is in addition thereto----------$------

Gross assets as shown by answer to question 9--------$------
Aggregate of deductions from gross assets as shown by answer to question 19----------$------
Subtract the deductions from the above assets--------$------
Add "secured debts" upon which no registration tax has been paid ----------$------

The result is the Capital Stock liable to Taxation------$------

The principal office or the place of transacting the financial business of the said corporation is situated in the City or Village of ---------- Town of ---------- County of ----------

STATE OF NEW YORK. }
County of ---------- } ss:

I, ---------- the ----------
of the said corporation, being duly sworn, do hereby certify that the foregoing is in all respects a just and true statement of the property and debts of the corporation on the first day of July, 191---- The statement is in accord with the books of account of the corporation except as otherwise noted.
Sworn to before me this------day of---------- 191----
----------"
Notary Public.

It would therefore seem that the purport of these instructions was for the assessor to make an arbitrary and excessive assessment against every corporation subject to assessment under Section 12, and then place upon the corporation the burden of getting such arbitrary assessment reduced.

This illustrates the difficulty of administering the present tax law, and also the unfairness and discrimination that necessarily results in case it is possible to in any way administer the present law relating to the taxation of personal property of domestic corporations.

The chief objection to this method of assessing the personal property of domestic corporations in an attempt to administer the present tax law would seem to be that it substitutes an arbitrary assessment

for a judicial assessment as contemplated by the tax law. This law contemplates that the local assessors throughout the State shall exercise quasi-judicial functions in making assessments. This fact is fully recognized by the present State Tax Commission. In its Manual of Instructions to Assessors issued in May, 1916, we find the following on page 13:

> "When completed the assessment roll should be the result of the deliberate, careful and conscientious judgment of at least two of the three assessors in each district."

It is, of course, impossible to get deliberate, careful and conscientious judgment, or any judgment at all, if under our tax law we find it necessary to resort to arbitrary assessments. This condition would seem to be a potent reason for the elimination of Section 12.

FRANCHISE TAXATION

Under Section 182 of the tax law certain business corporations are required to pay a franchise tax in addition to the tax prescribed by Section 12 of the tax law. Section 182 is exceedingly complicated, but the rate of tax thereunder in general depends upon the rate of dividend declared being one-fourth of a mill upon each per centum of dividends declared. The base of the tax, generally speaking, is such a proportion of the value of the issued capital stock as the property of the corporation in the State bears to the total property wherever located. This section has been very generally condemned by practically all individuals qualified to speak upon the subject, not only because of the complexity of the section and the confusion necessarily resulting in the administration of it, but also because of its unsoundness from a scientific and economic standpoint.

Mr. John J. Merrill, at present a Deputy State Tax Commissioner, has undoubtedly had more experience in the administration of Section 182 of the tax law than any other individual. Mr. Merrill in speaking before the First State Conference on Taxation of the State of New York, held in Utica, N. Y., in January, 1911, in referring to said section, said:

> "The taxation by the State of franchises of corporations, based upon their capital stock, as the law now stands and as construed by the courts, constitutes a sadly mixed and inadequate system. This is due to three concurring conditions,

> namely, (1) That the courts in construing this law in its earlier conditions held that as to domestic corporations the tax was based upon their franchises, but as to foreign corporations it was a tax upon a business done and was measured by the actual amount of 'capital' employed, as distinguished from 'capital stock.' In the attempt to distinguish between and define 'capital' and' capital stock' some 'fearful and wonderful' results were attained, and in later years the effort to follow these earlier decisions has tended to lead us farther and farther into the intricate mazes of doubt and disaster."

Professor Edwin R. A. Seligman at the same Conference in discussing the same law said:

> "But even in those cases where a precise rule is laid down, the rule is not by any means free from objection. Take, as an example, our so-called annual franchise tax on domestic and foreign corporations. Who does not know how we came, almost a generation ago, to copy a method that had been introduced shortly before in Pennsylvania? But I wonder how many know that when Pennsylvania came to look over the whole problem of taxation in a broad and comprehensive way, she changed in most essential respects the plan which we have adopted, and which was found not to secure the justice and equality which they desired. Our annual franchise tax, with its complicated scheme of calculation, and with its utter disregard of bonded indebtedness, forms a method which has been practically abandoned by our sister States. This is not the place to attempt the elaboration of the proper principle that should obtain in any comprehensive and uniform system of corporate taxation; but this is the place to protest against the permanent continuation of antiquated methods, and it is the place to voice the demand for a movement which shall result, not only in the adoption of definiteness and precision in lieu of arbitrariness, but for at all events some correspondence between administrative rules and sound economic principles."

Professor Seligman also referred to the same law in his work entitled "Essays on Taxation," and in that work he had this to say concerning Section 182:

> "The tax is assessed according to the capital stock. Originally the rate was just one-half of that of the original Pennsylvania prototype. At present, however, the rate of tax is determined according to very complicated rules. In reality there are in New York no less than six different classes, although the rather confused law does not clearly differentiate them."

Mr. Harrison Williams, Tax Agent of the Erie Railroad, in speaking upon the same subject before the First State Conference on Taxation of the State of New York above referred to, made the following statement concerning such section:

> "The assessment of capital stock is in such chaotic condition that it is, I think, a fair statement that no one could possibly explain the administration of the law as to-day actually in force, by a mere study of the face thereof. It has been construed in a manner which from a mere perusal of the statute seems little less than fanciful. The decisions are by no means uniform and the status of a given corporation thereunder to-day is one of the most technical and difficult questions an attorney specializing in taxation is called upon to answer. The latest result of the constantly added amendments has been the recent decisions of the Court of Appeals in the case of non-dividend paying corporations, reducing the State's revenue from those sources by many hundreds of thousands of dollars annually, although it is thought by those who were instrumental in drawing the portion of the law construed that such construction is wholly at variance with the intention of the Legislature which passed the amendment."

The Courts have also severely criticised the method of taxing corporations under the present Section 182 of the tax law.

Judge Cullen in the case of People ex rel., etc., Co. v. Roberts, 168 N. Y. 14, in construing said section said in the opinion:

> "We are quite aware that despite our construction of the statute there will still remain in it some inconsistencies and apparent unfairness in particular cases. The remedy in those cases must be an appeal to the legislature for modification of the law."

Judge Haight in the case of People ex rel. New York Central v. Knight, 173 N. Y. 255, in writing an opinion under such section and concluding that Section 182 must be read with the present Section 193 of the tax law, said:

> "The two sections are apparently conflicting. In such cases it is the duty of courts to reconcile contradictory or conflicting provisions when possible, and the case cited is a precise authority for the principle that the tax should be based upon the actual value. This permits the statute to operate in a way that is reasonable and just, while the other view would render it even more confusing than it now is. Courts cannot always follow logical reasons when dealing with a complicated statue constructed without much method or system in the arrangement of its different parts and lacking in clearness and precision of language."

Judge Werner in the case of People, etc., v. Williams, 198 N. Y. 238, in construing Section 182 said in the opinion:

> "But even if we concede that this difference in the phrasing of the two subdivisions of the same section is indicative of an intent to tax non-dividend paying corporations with impaired capital upon the basis of the par value of their capital stock, we cannot escape the conviction that a very simple idea which might have been framed in very plain language has been obscured in a mass of verbiage much better calculated to conceal than to reveal the true intent."

The same Judge in a later case entitled People ex rel., etc., v. Gaus, 198 N. Y. 250, made the following statement concerning such section:

> "The addition of a few words would have made the meaning of this part of the statute so clear as to preclude mistake or misunderstanding. As it stands, it is doubtful and equivocal."

It was the necessary confusion that resulted in construing the system of taxation under the present Section 182 of the tax law that evidently caused Judge Learned in an early case (People v. Delaware & Hudson Canal Company, 54 Hun. 598) to lose all faith in legislators, for in construing the law at that time Judge Learned said:

> "Any one who knows how statutes are passed must be aware that the intent of the legislature would be extremely difficult to ascertain; if indeed, in the minds of many of the legislators any such thing existed at all."

The method of taxing corporations under the present Section 182 of the tax law was originally contained in Chapter 542 of the laws of 1880. The law has been repeatedly amended since that time, more especially by the laws of 1882, 1889, 1890, 1896, 1901, 1906, 1907, 1910, and a most drastic amendment was offered at the last session of the legislature, which was not adopted.

If any reliance can be placed upon the opinions expressed by experts and by judges in reference to the scheme of taxation provided for under Section 182, and if numerous amendments are any criterion whatever, it would seem that it would be difficult to imagine a more complicated, confusing and unscientific method of taxation than that provided for under Section 182 of our present tax law.

It cannot be said that even now the law is settled as to the intent and meaning of Section 182, notwithstanding the numerous amendments to that section and the multitudinous number of decisions thereunder by the courts of the State. As late as September, 1916, the Appellate Division of the Third Department handed down a decision in the case of People ex rel. Ridgewood Land and Improvement Company v. State Tax Commission, holding that: "Where a stock corporation, organized under the Act of 1848 and amendments thereto, for the purpose of 'purchasing, taking, holding and possessing real estate and buildings, and selling, leasing and improving the same,' has disposed of all its real estate and buildings, receiving payment therefor partly in cash and partly in purchase-money mortgages, has distributed among its stockholders the cash so received and is engaged in collecting and so distributing the sums due on said mortgages, it is not subject to tax under Section 182 of the Tax Law for the privilege of doing business or exercising its corporate franchises in this State.

"Sums so distributed to the stockholders, even though they consist in part of interest on purchase-money mortgages or balances thereof, do not constitute 'dividends' within the meaning of Section 182 of the Tax Law.

"The capital of the corporation is not 'employed within this State,' nor is it 'doing business or exercising its corporate franchises' therein, by the mere holding of a purchase-money mortgage and the distribution among stockholders of the principal and interest thereof as collected."

We quote from the opinion in that case as follows:

> "Upon the broader question of whether the capital of the relator was employed in this State, we are not persuaded that the mere holding of a purchase-money mortgage and the distribution of the principal and interest as it is collected, constitutes doing the business for which the relator was incorporated. It has authority under its franchise to be a corporation to 'acquire by grant, gift, purchase, devise or bequest; to hold and dispose of such property as the purposes of the corporation shall require, subject to such limitations as may be prescribed by law' (General Corporation Law, sec. 11), and this power would seem to be sufficient to warrant the corporation in holding a purchase-money mortgage during the time that it was necessary to collect the principal and interest, without being held to be exercising its franchise to do the things which were specially permitted to it under its charter. At least we are unable to see any clear distinction between the case at bar and that of Lehigh

> & N. Y. R.R. v. Sohmer (217 N. Y. 443), so far as this particular point is concerned, and we are disposed to leave the distinctionfi, if one is to be made, to the Court of Appeals."

It therefore seems that although this law was first enacted in 1880, and has been amended many times since, to meet the many difficulties arising thereunder, we now find our Appellate Division calling upon the highest court in the State to pass upon a certain phase of this Act, for the reason that the Appellate Division does not feel fully competent to make the decision.

Under Section 183 of the tax law manufacturing corporations and certain other corporations therein mentioned are exempt from the payment of the franchise tax provided for under Section 182, provided the corporations named in Section 183 invest at least 40% of their capital in their regular business in the State of New York. It would appear that manufacturing corporations, which undoubtedly constitute the most important class under Section 183, were promised exemption from this franchise taxation, if they would invest 40% of their capital in manufacturing in the State.

At the last session of the legislature a bill was introduced having for its object the repeal of Section 183, so as to subject manufacturing corporations to taxation under the confusing system covered by Section 182. Manufacturing corporations very generally, objected to this measure upon the ground that it would amount to a repudiation of a contract between them and the State of New York, which contract guaranteed to such corporations an exemption under Section 182 if they made a permanent investment of 40% of their capital in the State, and inasmuch as certain manufacturing corporations had relied in good faith upon such exemption and had fully performed their part of the contract by making a permanent investment of 40% of their capital in the State, to now remove such exemption, they contended, would constitute an act of bad faith upon the part of the State. Whether or not this argument were sound it would seem to be a fact that any corporation would be justified in opposing any act that would bring it under so confusing, complex and unscientific a method of taxation as that contained in Section 182.

We have endeavored in the foregoing to briefly summarize the tax situation in the State of New York concerning business corporations under the law and its administration by the tax officials. Let us now take some concrete examples and ascertain if we can the probable results in case the present tax law could be reasonably enforced and

was enforced by the tax officials. As the discrimination under the enforcement of the present tax law would appear to be more glaring against domestic manufacturing corporations than other business corporations, we will consider a domestic manufacturing corporation in the following illustration:

Let us consider a tax district containing only the following taxpayers, to wit:

(1) A domestic manufacturing corporation.
(2) A foreign manufacturing corporation.
(3) A copartnership engaged in manufacturing, and
(4) An individual engaged in manufacturing.

Let us assume that each taxpayer has the same amount and kind of property, is engaged in the same kind of business, and that there are no other taxpayers in the district.

The reasonable value of all of the property of each of the above mentioned taxpayers, let us say, is as follows:

Description	Value
Real estate and fixed machinery	$160,000
Machinery and tools not part of realty	20,000
Goods, wares and merchandise	160,000
Notes and accounts receivable	60,000
Corporate securities (bonds)	100,000
Cash	100,000
Total property	$600,000
Stock issued by corporation, say	$600,000

Now, as each taxpayer is located in the same district, has the same amount and kind of property, and uses it for the same purpose, it is obvious that each ought to have identically the same assessment and bear identically the same tax burden, but watch what happens:

A. We will first take the domestic manufacturing corporation having the above described property taxable under Section 12 of the tax law. This corporation, say, has made report either prior to its assessment or subsequent to it as a result of excessive assessment. The result is as follows:

Total property shown by report	$600,000
Less assessed value of real estate, say	96,000
Total personal property assessment	$504,000
Real estate assessment	96,000
Total assessment	$600,000

NOTE: In this example we have assumed that the real estate is assessed at 60% of value. This, we believe, is about the average rate. In any event, we are using the same rate of actual value in all examples shown herein, so the rate is not so important. Of course, the fact that the real estate is assessed at less than actual value, is of no benefit to the domestic corporation because the difference between the actual value and assessed value, if any, is added to the personal assessment under Section 12 of the tax law.

B. Next take the foreign manufacturing corporation, taxable under Section 7 of the tax law, no report being required of a foreign corporation.

Real estate and machinery, assessed same as domestic manufacturing corporation		$96,000
Machinery and tools, without report probably not more than 50%	$10,000	
Goods, wares and merchandise, without report probably not more than 50%	80,000	
Notes and accounts receivable, without report probably not assessed	----	
Corporate securities (bonds) not assessed	----	
Cash, without report probably not assessed	----	
Total personal property assessment	$90,000	
Total real estate assessment	96,000	
Total assessment		$186,000

NOTE: As the foreign corporation makes no report, it is probable that it could successfully contend that its notes, accounts, cash and other intangibles were located outside the State where its principal office was located.

C. Next take the co-partnership engaged in manufacturing, taxable under the general provisions of the tax law, no report being required.

Real estate, assessed same as domestic manufacturing corporation		$96,000
Machinery and tools, probably not more than 50%	$10,000	
Goods, wares and merchandise, probably not more than 50%	80,000	
Notes, accounts, etc., probably	----	

Corporate securities, probably	----
Cash, probably	----
Total personal property assessment	$90,000
Total real estate assessment	96,000
Total assessment	$186,000

D. The assessment of the same property in the hands of an individual engaged in manufacturing would probably be the same as the assessment against the co-partnership, viz.:

Total personal property assessment	$90,000
Total real estate assessment	96,000
Total assessment	$186,000

We realize that these assessments would vary in different localities, but we believe that the result of the investigation by the Joint Legislative Committee on Taxation of the State of New York, of which our friend Senator Mills was Chairman, established that intangible personal property such as bonds, cash in bank, notes and accounts receivable, and any property which the assessor could not see, escaped taxation generally in this State in the hands of individuals and co-partnerships. The passage of the secured debts law tends to substantiate this view. In regard to tangible personal property such as live stock, machinery and merchandise, we think, as a rule 50% of the actual value would fairly represent the actual assessment upon the part of the local assessor. This was the experience in Massachusetts where the individual was required to file a report with the local assessor, in default of which he was doomed to the assessment made by the assessor. Therefore, if Massachusetts, where a report is required from individuals, does not assess tangible property at more than 50% of actual value on the average, it would seem that New York, where no report is required, would not assess such property at a greater percentage of actual value.

It therefore seems that the assessment of the four taxpayers above mentioned, all having the same property, would be represented as follows:

	Total Assessment
A. The Domestic Corporation	$600,000
B. The Foreign Corporation	186,000

C. The Co-partnership	186,000
D. The Individual	186,000
Total assessment in district	$1,158,000

Let us assume that the rate of tax was 3%. Then the taxes paid would be as follows:

A. The Domestic Corporation	$18,000
B. The Foreign Corporation (less than ⅓ as much)	5,580
C. The Co-partnership (less than ⅓ as much)	5,580
D. The Individual (less than ⅓ as much)	5,580
Total tax raised	$34,740

In other words, while the domestic corporation owns but 25% of the property in the district, it pays over 51% of the amount of tax. In other words, the tax against the domestic manufacturing corporation is more than three times that of any other taxpayer in the district having the same amount of taxable property. This, we think, is the necessary result of an assessment under Section 12 of the tax law in case such section is rigidly enforced.

You will recall that the present State Tax Commission in the forepart of the letter of instructions referred to herein, advocated the treating of all property alike in the matter of assessment, yet, upon a careful analysis of the situation it seems that the result is necessarily a discrimination against corporations that are assessed under Section 12 of the tax law, unless they have debts to offset the assessment.

Of course, if the taxpayers considered had had debts (the above property being considered exclusive of all indebtedness) the situation would have been different. But, then, indebtedness is a matter of exemption from taxation, and we are concerned here with taxation rather than exemption from taxation. We must also point out that if the domestic corporation had been fortunate enough to have had a surplus—that is, if its total assets had exceeded its liabilities, including its issued and outstanding capital stock—such surplus would have been exempt up to an amount not exceeding 10% of the issued capital stock.

If the bill advocated at the last session subjecting manufacturing corporations to a franchise tax in addition to their other taxes, had

been passed, the discrimination against manufacturing corporations as compared with individuals, would have been even greater than it now is.

Let us see what additional franchise taxes the domestic corporation would have had to pay if this franchise tax bill had been passed.

The capital stock of this corporation was	$600,000
Its net earnings were, let us say	$75,000
It could declare a dividend of 10%, amounting to	60,000
And carry to surplus	$15,000

The rate of tax would be ¼ mills for every 1% of dividend, or 10 times ¼ mills, which is $.0025 the tax rate. $600,000 times $.0025 is $1,500, the franchise tax.

The total property tax was	$18,000
The franchise tax would be	1,500
Total tax of domestic company	$19,500
Of course the individual pays no franchise tax, his tax would still be	5,580
This would make the total tax of the domestic corporation	$13,920

greater than that of the individual having the same amount of taxable property and transacting the same business in competition with the corporation. To put the proposition another way, the corporation would have to earn $13,920, or over 2.3% more on its investment than the individual would have to earn on the same investment, to enable the corporation to compete with the individual in the sale of its products, all due to this discrimination in taxation.

Of course, the co-partnership would be in just as favorable a position as the individual, because the co-partnership would be taxed precisely the same as the individual.

The foreign corporation would be favored in connection with its taxation upon property, as we have seen, but would be subject to the franchise tax in proportion to the amount of property invested in the State.

Another difficulty is that other States have much more favorable tax laws for corporations than the laws of this State. For example, let us consider a foreign corporation with the same kind and amount of

property as the domestic manufacturing corporation herein mentioned, the foreign company being organized in Pennsylvania and having its property located in that State.

In Pennsylvania manufacturing corporations pay no personal property taxes nor franchise taxes whatever. The real estate is not taxable at all in that State for State purposes. Therefore, the only taxes payable by a Pennsylvania manufacturing corporation are local taxes assessed upon the real estate.

Let us therefore consider the taxes that would probably be paid by a Pennsylvania manufacturing corporation having the same property in Pennsylvania as the New York manufacturing corporation herein considered.

Description of Prop.	Reasonable Value.	Amt. of Tax
Machinery and tools	$20,000	----
Goods, wares and merchandise	160,000	----
Notes and accounts receivable	60,000	----
Corporate securities (bonds)	100,000	----
Cash	100,000	----
Real estate	160,000 (probably)	$2,560

In figuring the amount of local taxes payable upon the real estate, we have assumed that the real estate would be assessed at 80% of its value and that the tax rate would be 2%. The rate of assessment and the rate of tax would undoubtedly vary in different localities, but we believe, based upon our experience, that the foregoing rates would fairly represent the average in Pennsylvania.

The Pennsylvania corporation would therefore pay an annual tax of about $2,500, whereas the New York corporation, with identically the same kind and amount of property, if assessed under Section 12 of the tax law and subjected to the franchise tax under Section 182, would pay an annual tax of about $19,500. In other words, the tax paid by the Pennsylvania corporation ($2,500.00) in Pennsylvania, would represent only about .4 of 1% of its total investment of $600,000, whereas the tax paid by the New York corporation ($19,500.00) in New York would represent about 3¼% of its total investment of $600,000. If we assume that the net earnings of these companies amount to $75,000 in each case, and they probably would not exceed that figure, then the Pennsylvania corporation would pay in taxes only about 3⅓% of its net earnings, whereas the New York corporation under the proposed conditions would pay in taxes about 26% of its net earnings.

More than this, the Pennsylvania corporation could actually place its manufacturing products in direct competition with those of the New York manufacturing corporation. Under the decisions of our courts the Pennsylvania corporation could do the following things in this State without being amenable to our tax laws and therefore paying no taxes in the State of New York:

(a) It could transmit to its agent here its manufactured product for sale, provided the proceeds were transmitted forthwith to the home office in the State of Pennsylvania. (See People ex rel. The Parker Mills v. Com'rs of Taxes, 23 N. Y. 242.)

(b) It could maintain a salesroom in a city in this State where it could keep on hand its manufactured products for sale in this State and could keep on hand sufficient funds to pay office expenses, provided the proceeds of the sales were not invested here, but were transmitted to its home office in Pennsylvania. (See People ex rel. Sherwin-Williams Co. v. Barker, 5 App. Div. 246, affirmed 149 N. Y. 623; People ex rel. Tower Co. v. Wells, 98 App. Div. 82, affirmed 182 N. Y. 553.)

(c) It could maintain an office here for holding directors' meetings and paying dividends, maintaining a sufficient bank account in this State to pay its dividends. (See People ex rel. Dives Pelican Co. v. Feitner, 77 App. Div. 190.)

(d) It could maintain an office here for the purpose of the general solicitation for its goods, and for the delivery of its goods to customers here where such orders were subject to approval outside the State. (See People ex rel. Goetz Mfg. Co. v. Wells, 42 Misc. 86, affirmed 93 App. Div. 613.)

Now, if domestic manufacturing corporations are to be taxed in this State in the manner prescribed by Sections 12 and 182 of the tax law, how are the products of such corporations to compete under such conditions with the products of individuals, co-partnerships and foreign corporations transacting the same kind of business? Would not this policy necessarily drive manufacturing capital out of the State of New York? Would not manufacturing capital, if this policy were followed, hereafter be invested in States like Pennsylvania, rather than New York? Therefore, would not this policy if consistently followed eventually result in decreased rather than increased revenue for the State?

PROPOSED REMEDY

It is perhaps difficult to propose a fundamental change in the tax law of a State that will meet the general approbation of all persons interested in tax reform. It has been generally conceded, however, by those who believe in the taxation of personal property, that it should be taxed at a lower rate than the general rate now imposed upon real estate. This matter was very clearly and concisely set forth in regard to the taxation of tangible personal property by Professor Charles J. Bullock in his paper entitled "The State Income Tax and the Classified Property Tax," read at the Tenth Annual Conference of the National Tax Association. Professor Bullock said:

> "Tangible personal property continues in all the States, except Minnesota, to be taxed like real estate. Yet it would seem that in a proper scheme of classification this kind of property should be segregated and taxed at a special rate. It consists, for the most part, of merchandise, machinery, and live stock, property which may be assumed to be employed in trade and to yield an ordinary trade profit which may be taken to be about ten per cent. From property of this description, which is mobile and subject to severe interstate and even international competition, it is doubtful if any of our States ever has collected, or can expect to collect, taxes that absorb more than ten per cent of the income. Since $100 of such property may be assumed to yield an average income of about $10, the proper tax rate would be 80 cents or $1.00 per $100; but the rates prevailing in our States are usually double these figures. The result is general undervaluation, by which tangible personalty as a class is assessed at from 30 to 60 per cent of its true value, while in individual cases assessments range from nothing up to 100 per cent, producing the grossest inequalities between taxpayers. The introduction of better methods of taxing intangible property has indeed simplified and improved somewhat the taxation of tangible personalty, the efforts of efficient State tax commissions have changed things for the better, but the problem has not been solved.
>
> "For manufacturing and commercial States the question is one of the greatest importance. In these commonwealths public expenditures are usually heavy and tax rates are high. Strict enforcement of a tax amounting to $1.50 to $2.50 per $100 would not be long tolerated by public opinion, since it would drive so much business to other States. The rational, expedient, and straightforward thing to do is to reduce the tax to a figure that can be collected, and then enforce the law in all cases without fear or favor. When expenditures are small and the general tax rate does not equal or exceed $1.00 per $100, the matter may

not be of great importance; but elsewhere the proper classification of tangible personal property is becoming increasingly desirable and necessary.

In principle it would appear that it is not important what logical method were pursued in classifying personal property and requiring it to pay a reasonable proportion of the tax burden. The method pursued would seem to depend largely upon the experience and sentiment of the State where the reform lgislation was to be attempted. Professor Bullock in the paper above mentioned stated this view in the following language:

> "In any State one's choice should be guided largely by public opinion. If the Rhode Island Commission of 1911 had recommended a State income tax, instead of a flat tax on intangibles, its report would have fallen upon deaf ears. If recently a flat tax had been proposed in Massachusetts, instead of a State income tax, nothing would have come of it. Since the only thing that matters is to get a proper classification of the objects of taxation, names are of no account and we ought to follow the line of least resistance."

Perhaps the people of the State of New York are in a better position to suggest a remedy than the people of the average State who have to meet this problem, because we have recently had a full investigation in this State by a Joint Legislative Committee. This Committee filed its report February 14, 1916. We quote from the conclusion on page 206 of the Report of this Committee as follows:

> "The Legislature submitted to this Committee the question: 'How can the State most equitably and effectually reach all property which should be subjected to taxation and avoid conflict and duplication of taxation on the same property?'
>
> "Without passing upon the broad questions of public policy involved in the adoption of a new tax system, which questions should more properly be decided by the Legislature as a whole, this Committee, in answer to the specific question submitted to it, desires to state that all the evidence presented and all our investigations, the results of which are presented in full in this report, tend to show that the end sought for will be accomplished best by: (1) the abolition of the present tax on personal property; (2) the withdrawal of general business corporations from the provisions of Section 182 of the tax law; and (3) the imposition of an income tax on individuals and general business corporations, including manufacturing corporations."

It is probable that the Committee not only found that the income tax suggested was best suited to meet the needs of the situation in the

State of New York, but that it was a reform measure operating along the lines of least resistance, as suggested by Professor Bullock in the paper above referred to.

It is probable that business corporations as well as individuals of this State would seriously object to the filing of an inquisitorial report concerning their assets and property, but inasmuch as they are required, whether they desire to do so or not, to file an income tax report with the Federal Government, it would seem that they could have no serious objection to filing a duplicate of such report with the State authorities for the purpose of an income tax assessment under a State income tax law. This position is strengthened when we consider that the information contained in the Federal report of these corporations is already available to any State official upon application to the Federal Government.

It would therefore seem to follow under present conditions in this State that the enactment of a State income tax, taxing the income of business corporations, would be proceeding along the lines of least resistance, and certainly it would seem that this or any other reasonable taxation scheme which eliminated Sections 12 and 182 of the present tax law, and at the same time provided for a reasonable tax upon personal property, would be a vast improvement over present conditions.

No one who has given the matter sufficient attention can object to the theory of an income tax, to be enacted in lieu of a confiscatory tax upon personal property. It is contended, however, by some who are opposed to net income taxation that the cost of collection of a net income tax is prohibitive. In other words, they contend that the amount of revenue received does not warrant the effort and expenditure upon the part of the State, made necessary for the purpose of collecting the tax. The preliminary report of the Commissioner of Internal Revenue dated August 1, 1916, shows that the total amount of income taxes collected by the Federal Government for the governmental fiscal year ended June 30, 1916, was $124,937,252.61. The total appropriation for the income tax for that year was $1,501,360.00. In other words, the additional expense incurred by the Commissioner of Internal Revenue because of the collection of the income tax, in addition to the other work of the department, was $1,501,360.00. By comparing this appropriation with the amount of income taxes collected it will be seen that the cost of collecting the income tax by the Federal Government was approximately 1.2%.

In the State of Wisconsin, according to the report of the Tax Commission, the cost of collecting the income tax amounts to from about 1.11% on the amount assessed to 2.77% on the amount collected. I quote from the report of the Wisconsin Tax Commission submitted December 3, 1914, as follows:

> "The assessors of incomes, it will be remembered, took over the duties and powers of the old county supervisors of assessment, whose salaries and expenses had been borne by the several counties of the State. They perform in addition to their work in connection with the income tax the duties performed by the old county supervisors of assessment, and do the work very much better. The cost of the supervisors of assessment in the last year in which they held office was in round figures $54,000. In estimating the cost of the income tax, therefore, at least this amount should be subtracted, leaving for expenses of the income tax proper $45,252.24 during the year 1912-1913, and $45,-197.59 for the year 1913-1914. The income tax assessed the first year amounted to $3,482,145.66. The income tax assessed the second year amounted to $4,084,497.40. On this basis, therefore, the income tax cost to assess and to administer the first year 1.31 per cent, and the second year 1.11 per cent. On the basis of the actual cash collections, the income tax cost the first year 2.77 per cent, and the second year 2.33 per cent."

In the State of West Virginia the State Tax Commission advises, under date of October 5th, 1916, that the income tax in that State imposed upon corporations, for the year 1915 will yield approximately $350,000, with an approximate cost to the State of $7,500.00. Upon this basis it would appear that the cost of collecting the income tax in West Virginia is approximately 2.1 per cent.

In the State of Connecticut, where there is an income tax of 2 per cent upon a proportion of the net income of business corporations transacting business in that State, the cost of collection has been reduced to a minimum. This is due to the fact that under the Connecticut law the State accepts as a basis of taxation any report that is acceptable to the Federal Government, and basis its tax upon the conclusions reached by the Federal Government in imposing the Federal Income Tax. This gives the State tax department the benefit of all the expensive machinery of the Federal Government in ascertaining the proper amount of net income taxable to any corporation, and the State tax department only has to determine by arbitrary rule what proportion of the total net income is taxable in the State of Connecticut. In a communication dated September 29th, 1916, from the State Tax

Commissioner of Connecticut I am advised that the receipts under the law for the first year will amount to approximately $1,600,000; that there has been comparatively little difficulty in the administration of the law, and that there has been practically no additional cost for collecting the tax, as the State tax department, as constituted prior to the enactment of the law, was able to take on the extra duty of collecting the income tax with comparatively little or no additional expense to the State.

Based upon information received from taxation officials who have successfully administered recently enacted income tax laws, it would appear that the opinion of those individuals who contend that the cost of collecting an income tax is prohibitive, is without foundation of fact, and contrary to the experience of such taxation officials.

CONCLUSION

In conclusion it is respectfully submitted that it would be no departure from sound economic theory if after the experience of the Federal Government and the States above referred to, the State of New York should undertake to impose a practical net income tax upon business corporations. And, it is further submitted that the writer knows of no better theory of taxing such companies in this State that has been suggested or recommended up to the present time, as a result of sufficient investigation and knowledge of the whole subject.

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